

Governor's Presentation of the 2006/2007 Annual Report

Maltin Moving Conference Centre, ECCB Headquarters, St Kitts
28 June 2007

Good evening fellow citizens of the Eastern Caribbean Currency Union.

I have chosen this medium to report to you on the performance of the Eastern Caribbean Central Bank in 2006/2007, because although members of the public do not deal directly with the ECCB, its operations significantly impact the life of every ECCU citizen.

A central bank is a unique financial institution. As a country's principal monetary authority, it manages the flow of money and credit in the economy.

The Eastern Caribbean Central Bank, which is one of only 4 multi-state central banks in the world, carries out this function across eight member countries, with the primary objectives of maintaining monetary and financial stability. That is, ensuring that the currency remains strong and stable, the financial system is safe and the supply of money and credit promotes economic development.

One of the ECCB's important functions is to provide member countries with a supply of currency. The Bank must ensure each country receives an adequate supply of banknotes and coins, which are in good condition.

I am happy to report that, notwithstanding the increased demand resulting from the hosting of ICC Cricket World Cup, the ECCB was able to fully satisfy the countries' currency requirements throughout the year. EC Currency in circulation at 31 March 2007 was \$706 million, of which banknotes accounted for \$641 million, and coins amounted to \$65 million.

The supply of currency was not, however, without its challenges, among them being significant costs associated with minting new coins and transporting the currency to

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member countries in an efficient manner. In fact, since our currency related costs are among the largest items on the ECCB's income and expenditure statement, we have to make every effort to contain them, and you, the members of the public, have an **important** part to play in this regard. Costs incurred for minting new coins are the direct result of the non-return of coins to the system. We are appealing to you to return your EC coins to the commercial banks.

The Bank also has a responsibility to secure the banknotes against counterfeiting, and, in this regard, has hosted 'Know Your Money' seminars in the member countries over the years, as a means of informing the public about the security features of the notes. In 2006/2007, seminars, facilitated by counterfeit specialists from the US Secret Service and De La Rue Currency in the UK, were held in Antigua and Barbuda and Saint Lucia. The ECCB officials conducted similar sessions in the other countries.

The Bank takes actions to regulate the availability of money and credit. Such actions must be in keeping with national economic goals and target the achievement of economic growth, stable prices, high employment, low inflation, leading ultimately to high standards of living and an improved quality of life for all citizens.

The cornerstone of the ECCB's monetary policy framework is the fixed exchange rate. By pegging the EC dollar to the US dollar at the rate of 2.7 to 1, we have been able to keep inflation in the ECCU in line with our main trading partner, the USA and maintain the purchasing power of the EC dollar.

To maintain the peg, the ECCB holds foreign exchange in reserve, in anticipation of the countries' future payments or obligations. In this regard, the legal stipulation is that foreign exchange reserve should be equivalent to 60 per cent of the currency in

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circulation and other demand liabilities. I am happy to report that at 31 March 2007, the ratio stood at 99.6 per cent, well above the statutory requirement.

Several other factors influence the maintenance of the peg. Among these are:

1. The performance of the balance of payments - that is the record of our payments to and receipts from foreign countries;
2. Growth in money and credit, which must be at a pace that keeps the value of our money stable and leads to steady growth in the economy;
3. Interest rate developments; and
4. The compatibility of the Bank's monetary policy with the fiscal policy of the member governments, that is their taxation and spending policies. Our governance structure facilitates this process, since the members of our Monetary Council - the Bank's highest decision making body - are the ministers of finance from the eight member countries.

Let us now look at how these factors performed in 2006/2007:

- Following a rise to 3.5 per cent in 2005, inflation in the ECCU fell to 2.8 percent, as international oil prices moderated in the latter part of the year. The average rate in the ECCU fell below the rate in the USA.
- A surplus in the balance of payments, led to an increase in the bank's stock of foreign reserves, and the strengthening in the backing of the currency to 99.6 per cent of the Bank's demand liabilities.
- ECCU economies grew to levels above 6 per cent, driven largely by construction activity related to Cricket World Cup 2007; and
- The ECCB worked very closely with the member countries throughout the year to ensure that the fiscal and debt management policies were in alignment with the requirements of the fixed exchange rate policy.

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In keeping with the objective to promote economic growth and development, the Bank provides policy advice to the member governments. The ECCB's economists monitor financial and economic developments in the regional and international markets and provide economic projections and policy analyses geared at enabling the countries to become internationally competitive.

Given the changing international environment, the ECCB developed new models to assist the regional economies as they realign themselves in the global arena.

Managing the reserve is another of the ECCB's important responsibilities, and throughout the year the Bank introduced new instruments as a means of increasing the returns on the foreign reserve portfolio, and strengthened the arrangements for safeguarding the assets in this portfolio.

Let us now look at the measures taken by the ECCB to promote financial stability.

A safe efficient financial system is a necessary condition for financial stability. In the Eastern Caribbean Currency Union the financial system consists of:

- Commercial banks and non-bank financial institutions, such as credit unions and insurance companies;
- the payments system, through which funds flow from one financial institution to another and transactions are cleared and settled; and
- the money and capital markets, where funds are raised through the issuance and trading of securities.

Regulation of the financial system is shared by the ECCB and the member countries.

The ECCB:

- Supervises the operations of the commercial banks and non-bank institutions licensed under the Banking Act.

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It oversees the payments system and provides liquidity to the system and it gives administrative support to the Eastern Caribbean Securities Regulatory Commission which supervises the securities markets.

The ECCB also provides assistance with the drafting of financial legislation. However financial legislation is the responsibility of the member governments, whose agencies supervise the non-bank institutions not licensed under the Banking Act.

In supervising the operations of the commercial banks, the ECCB is required to establish safe and sound banking practices that protect the public's financial transactions and ensure stability of the financial markets. The ECCB examines the commercial banks regularly, to identify and contain risks to the commercial banking sector.

In 2006/2007, the ECCB conducted on-site examinations and issued guidelines to the commercial banks on corporate governance, liquidity risk management, related party transactions, internal auditing and the selection of external auditors. These guidelines are intended to improve risk management in the financial sector.

The Bank is cognisant that risks in any one area could jeopardize the entire financial system. The possibility of risks where responsibility for regulation is spread across different agencies is a very real concern. Accordingly, throughout the year, the ECCB collaborated with the member countries to consolidate supervision through single regulatory units. The single regulatory units will oversee and regulate the non-bank institutions, serving both as a means of strengthening supervision and enhancing the system.

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In 2006/2007, the ECCB worked closely with the member governments to expedite passage of the new Banking Act in all member countries and assisted with drafting both insurance and a money services bill. The Bank is also developing a legislative drafting model, to facilitate uniform financial legislation across the ECCU.

A sound payments system is a pre-requisite for financial stability, since it is the channel through which financial institutions exchange millions of dollars in electronic and cheque payments on a daily basis.

In 2006/2007, the ECCB continued efforts to strengthen the payments system, providing assistance to the governments with the drafting of a payments system bill, a money services bill and a bills of exchange (amendment) bill, all of which prescribe clear rules for transactions carried out on the system. Additionally, in October 2006, an Eastern Caribbean Payments Council, with membership from commercial banks and the ECCB, was appointed. This body has oversight responsibility for payments and securities clearance and settlements.

In furtherance of efforts to promote money and capital market development, the Bank continued to promote the Eastern Caribbean Securities Exchange as the exchange of choice for the CARICOM region. In December 2006, Trinidad Cement Limited joined Grace Kennedy of Jamaica and FirstCaribbean International Bank (Barbados) Ltd, as the third company outside of the ECCU bloc to list on the exchange.

We were able to demonstrate the vast technological capabilities of the ECSE to international financial investors by linking into the system from Singapore, during the IMF/World Bank annual meetings in October 2006. Additionally, successful links were made to the exchange from Guyana, Barbados and the British Virgin islands.

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The Bank also continued to work with member countries to enhance the securities legislation in order to facilitate trading and encourage greater participation in the markets.

I am pleased to report that activity on the Regional Government Securities Market improved significantly over the previous year. In 2006/2007 the number of securities issued increased from 18 to 30, and the value from \$369 million to \$665 million. Dominica listed three bonds on the exchange and became the sixth member government to participate in the market. Over time, the governments are expected to realise reductions in their cost of borrowing, and, as the number of securities increases, more investment opportunities will become available to the public.

We have constructed an index, the ECSE EC Share Index, to track the performance of the stock exchange. This index reflected the buoyancy of the market from 1st April 2006 to 31st March 2007, with growth of 10.4 per cent, exceeding the previous year's growth of 7.9 per cent. The dividend yield on domestic companies contributed to the market's momentum, averaging 6.8 per cent in 2006/2007, compared with 6.0 per cent in 2005/2006. After discounting for inflation, investors received a total real return in excess of 14 per cent.

Participation is an important aspect of capital market development. During the period under review, the ECCB continued to seek avenues for enhancing the private sector's capacity to participate in the markets. Significant progress was made in developing a framework for the Eastern Caribbean Enterprise Fund, a multi-country facility geared at providing equity, loan, and mentoring services to private sector entities. In collaboration with the OECS Secretariat, the Bank also began exploratory work on developing an OECS Distribution and Transportation Company. The objective is to provide an avenue for increasing trade between the members of the OECS, particularly

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in the area of agricultural commodities. This would enable the OECS countries to benefit from economies of scale in production, marketing and distribution, due to the existence of a common currency which lowers transaction costs and eliminates foreign exchange risks.

In furtherance of our commitment to promote business development and to infuse an entrepreneurial spirit in the region's youth, the Bank continued to partner with private and public sector institutions to introduce the Junior Achievement programme in the member countries. We welcomed Anguilla to the programme during the year and we are very pleased that the Junior Achievement has now been integrated into the schools' curriculum in St Kitts and Nevis.

Public understanding of financial and economic issues is one of the imperatives for maintaining monetary and financial stability. The ECCB therefore continued to undertake initiatives to build awareness about its work and to empower the public to make wise financial and economic decisions. Throughout the year, these included:

1. Briefings with the media, immediately following the meetings of the Monetary Council, at which Council members explained monetary policy decisions and responded to questions posed by the local media;
2. Regional interactive discussions on the economic performance of currency union countries;
3. Financial literacy month activities which are now institutionalised in the member countries.
4. Implementation of the savings and investment course, in collaboration with educational and financial partners, in six of our eight member countries. The course began in St Vincent and the Grenadines in April and we are making efforts to implement it in Dominica by the second quarter of this financial year.

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The ECCB compiled and published the *Sir Arthur Lewis Memorial Lectures, for the period 1996-2005*, as a means of providing insights into the macroeconomic and broader development challenges facing the region.

We now come to the ECCB's financial performance.

The ECCB achieved its primary objective of maintaining the ratio of total expenditure to income earned on foreign assets below 100 per cent. At 31 March 2007, the ratio was 81 per cent.

I am pleased to report that the higher than expected interest rates in the USA positively impacted the Bank's overall financial performance. This was largely attributable to the concentration of the foreign reserve portfolio in US dollar denominated instruments and the repositioning by money managers from longer-term securities into higher-yielding short-term money market instruments.

Operating income of \$92m exceeded the budgeted amount by \$17m. The Bank contained expenditure to \$58m, \$5 million below the budgeted amount, resulting in an overall favourable net income variance of \$22.m.

The conservative expectations for income, coupled with strict expenditure management controls contributed to a higher than expected operating profit of \$35m.

As at 31 March 2007, the Bank's total assets stood at \$2.1 billion, an increase of \$247m or 13.4 per cent, when compared with the position last year. The increase, reflected in an expansion of \$282m or 17.6 per cent in foreign reserve to \$1.9 billion, was due primarily to heightened economic activity in the ECCU, mainly in the construction and tourism sectors in preparation for ICC Cricket World Cup 2007.

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Overall, 2006/2007 was a successful year for the ECCB. In 2007/2008, as the OECS countries move towards an economic union, we will continue to face new and exciting challenges.

The focus of the ECCB's operations will be on improving efficiencies at all levels within the institution as we carry out our new responsibilities, while, at the same time, ensuring the stability of the currency, the safety and soundness of the financial system and the growth and development of the member countries.

Thank you and good night.